



The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

The Month in Washington: July 2006

Politics Crowd Policy as Lawmakers Fumble for Accomplishments

Many observers saw a recent front page story in a Capitol Hill newspaper as confirming a growing sense that the vast majority of the current Congress has been frittered away in largely pointless trench warfare. In that story, the Democrats said that they would run on criticism of the President's 2005 plan to privatize Social Security, while the Republicans would run on their accomplishments since 1994, when their party first took power, such as welfare reform (1996) and deficit reduction (1998-2001). These strategies verify that even amid war and a demographic crisis to the country's health and retirement resources, the political parties seem more comfortable talking about the past than the future.

This outlook has guided the fights of the Summer of 2006. Congress continued to dwell in the past, seeking partisan advantage by fighting over old ground again rather than seeking the compromise and meeting of the minds that could lead to a new place that improves the lives of Americans in the future.

The same general strategy of past over future affected the issues closer to home for CalPERS. GOP leaders continued to press for the inclusion of estate tax relief in the pension conference report, even though the Senate twice rejected the proposal. Senior Senate Democrats Max Baucus (D-MT) and Ted Kennedy (D-MA) joined with pivotal moderate Olympia Snowe (R-ME) to quash this plan, which was nevertheless still circulating at the "eleventh hour" of conference negotiations.

Similarly, discussion began on linking a minimum wage hike to a bill allowing small businesses to form health pools outside of the normal standards for coverage and pricing, a proposal which failed in the Senate and alarmed State officials who today regulate insurance. Brief talk of attaching a minimum wage increase to the pension conference came and went.

While still early in the election season, the opening moves of the political parties suggest a return to what they appear to know best: a strategy of division and polarization, from the reddest of red States to the bluest of the blue, from the Republican gerrymandered district to the Democratic one across the line. With an incumbent reelection rate approaching 98%, both parties seek out the remaining moderate districts to flip into their camp in order to gain enough seats to become the majority while the remaining districts stand as unchallenged bastions of partisanship. While it may be possible to win using these methods, for many, it is an open question whether such a path to victory leaves the nation effectively ungovernable.

Issues and Events

Senate Tax Leaders Call for Study of Public Plan Funding

The top law-makers on the tax-writing Senate Finance Committee, Chuck Grassley (R-IO) and Max Baucus (D-MT), took a break from the pension conference to ask the Government Accountability Office (GAO) to study public sector pension and health benefits. Grassley and Baucus asked the GAO to look at the following issues:

- “the general financial health of state and local government DB plans” over the last 10 years;
- coverage and funding details on retiree health plans in the public sector;
- the value of the Federal tax expenditure – i.e., the tax money forgone by the Federal government to provide incentives for retirement savings – to public employers and employees;
- the impact of new accounting standards on retiree health (OPEB) benefits; and
- the general trends in public sector benefits.

The letter makes several questionable assertions. Although the letter to the GAO says, “Many of the same forces that impacted private sector defined benefit plans impact public sector defined benefit plans,” public plans continue to be going strong while the lights continue to go out in the private sector with disturbing regularity. This wildly differing experience suggests that the same forces are not acting on the two systems, or at least not in the same way.

The letter to GAO also says, “Because of different rules, many of the public sector plans are even more poorly funded than their private sector equivalents,” yet public sector benefits are funded at 86% of liabilities and likely to rise as the last stock market correction is ironed out. The Senators write that, “There is no PBGC to back up these [public] plans; the burden would fall directly on state and local taxpayers and on our Nation's teachers, police and firefighters” yet many pension experts believe that the existence of the PGBC creates an all too easy escape hatch for private employers who want to dump their pension costs on someone else.

Perhaps most disturbing, the letter asserts that public employees need “help” to avoid the “the benefit losses and reduced accruals experienced by their private sector counterparts.” There is still not a single incidence of a promised public employee benefit that has been denied or diminished in part because anti-cutback laws at the State constitutional level protect most public sector benefits.

Grassley and Baucus also express concerns about health benefits and the new accounting rules related to them and request the GAO study as a way to “better understand the fiscal and other challenges facing state and local retirement plans.” Commingling pension and health benefits strikes many observers as a move with no other purpose than to create a shockingly large number, since retirement and health costs are generally looked at side by side, not together. For example, taking the Federal government’s pension (Social Security) and health (Medicare, Medicaid, and Veterans Administration) obligations together results in a shortfall of about \$50 trillion, or about five times GDP – a number which may dwarf comparable expenses in the State and local and private sectors combined.

Some see it as the height of hypocrisy for a Federal government which is so deeply “underwater” on its own obligations to go picking a fight with its State and local brethren – virtually every one of whom, thanks to pre-funding, is almost certainly far more financially solvent than it is. Many public sector benefits experts see the GAO letter as an attempt to establish a justification for Federal funding requirements for State and local plans. The more cynical see the GAO study as a gambit to establish cause for requiring public plans to pay PGBC premiums for insurance they historically have never used, which would solve the Federal problem with a deeply under-capitalized benefit insurance fund in the near term.

Two large industry groups, the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR), responded immediately. Other important players in the public pension community met to seek a common strategy toward the GAO study ordered by the Finance Committee leaders. The replies note the sterling record of public plans on delivering promised benefits, backed as they are by a legion of legal protections, oversight processes, and State and local taxpayers to provide a level of security far superior to that provided by a chronically troubled PGBC. The current funding rate of about 86% of liabilities found among public plans mirrors investment declines, now on the reverse course, which all market participants suffered. The replies include notice that public plans pay out more than \$130 billion annually, more than the economic output of 22 States.

The letters take the tone that the public plan community is happy to work with the GAO and Congress to address pension plan issues but has little interest in being railroaded as part of the general war on defined benefit plans. The shining example of public plans offers the opportunity for those with more unfortunate experience in retirement systems, such as the private and Federal sectors, to learn what has worked for many decades.

Pension “Conference of the Damned” Continues

As the conference on pension reform legislation (H.R. 2830) – begun on March 8, 2006 – approached its 150th day anniversary, reports say that the conference continues to be a forum for many contentious issues, delaying resolution of the underlying pension matters. At press time, there was still no conference report, even though the leadership has smoothed the way for the measure to be considered this Friday, July 28, 2006, should an agreement be reached. The House is scheduled to adjourn for more than a month at the conclusion of business today; should that occur without a conference report, yet another deadline will have passed with talk of a deal being “close,” “99 percent done,” and “basically resolved” but without actual legislation with which to move forward.

The benighted conference, which Senator Trent Lott (R-GA) previously called “one of the worst” he has ever seen, continued to attract issues from outside the scope of the two bills which entered conference. Over the course of the seemingly endless meetings, the conferees have discussed charitable giving rules for foundations, estate tax relief, minimum wage increases, and other concerns which, despite their individual merit, were not presented in either the House or Senate pension bills.

Negotiations continued at deadline for this edition. The latest reports augured poorly for a timely resolution, as House Republicans boycotted a vote on conference business. The

cause of the troubles stems from the leadership dropping the popular “extenders” (so named because they are constantly renewed or extended rather than made permanent) from the pension bill. It had been a given for more than a month that extenders would ride with the pension conference report, only the latest change in a constantly morphic setting where external issues enter the conference, internal ones are dropped, and larger Party goals such as the estate tax or minimum wage float in and out.

While many public pension advocates have felt that conferees consider the \$28 billion in EGTRRA permanency provisions to be too expensive for their tastes, there seems to be no end to other pricey provisions which have wandered into and out of consideration. The flurry of rumors and speculation surrounding the conference makes it almost impossible to offer any meaningful or accurate prediction about the final shape of the pension reform package until it concludes.

House Breaks Health IT Logjam

With little advanced fanfare, the House Rules Committee quietly made in order consideration of a substitute compromise on H.R. 4157, the Health Information Technology (IT) legislation, which has been delayed by an inter-committee squabble over several provisions, and the House passed the measure 270-148. The legislation now goes to conference with its companion Senate bill, S. 1418 passed last year by a unanimous vote of that chamber.

The Department of Health and Human Services (HHS) will study State privacy laws in an attempt to harmonize (i.e., recommend that Congress pre-empt) those regulations deemed to be too much of an imposition on the planned new system. The House compromise continues to rely on relief from anti-kickback and self-referral laws as the nearly exclusive means to encourage private entities to create the electronic health record network, although a small sum (\$40 million) is authorized to facilitate adoption of health IT. The House legislation also requires moving to the new International classification of disease (ICD) codes by 2010.

Democrats continued to point to the flaws of the House bill, noting that it has deficient protections for privacy and does nothing to really ensure interoperability among the various actors in the health system. Their complaints circulated in a letter http://www.house.gov/commerce_democrats/Press_109/109dc27.pdf sent the previous day that noted that the House bill does not require patient consent for sharing information, does not requiring notification of patients when their records' security has been breached, and does not require protections such as encryption for medical records. The letter claims the House bill “wastes taxpayer dollars by permitting and encouraging questionable relationships among various providers” and “offers a small fraction of the needed funding for the adoption and implementation” of health IT.

Congresswoman Doris Matsui (D-CA, Sacramento), a member of the Rules Committee, led the fight against the rule to consider the bill. She insisted that, if the leadership would allow a clean vote, a bipartisan bill based on that which the Senate passed unanimously late last year would win approval. Now unfortunately cast as the Dingell-Rangel Democratic substitute, the strange injection of partisanship into the health IT debate could further derail what had breezed through a U.S. Senate which is itself no stranger to bickering and infighting between the parties.

The measure cleared on a largely partisan vote Thursday afternoon after accepting several non-controversial amendments. Nonetheless, patient-oriented health advocates hope to leave as much of the House measure behind as possible in the conference with the Senate bill which they favor.

Leaders Mull Minimum Wage, Health Plans Combo

In an attempt to strike a compromise that advances the agenda of both moderates and conservatives, GOP leaders floated a plan this week to combine an increase in the minimum wage with legislation to create association health plans similar to the proposal of Senator Mike Enzi (R-WY) defeated earlier this year when it failed to overcome a 60 vote procedural hurdle. CalPERS, State regulators, and patient groups opposed the Enzi measure because of the belief that it would adversely affect health care consumers through loose or nonexistent standards on cost and covered procedures currently imposed by the States.

Opponents stymied the Enzi bill (S.1955) on a 55-43 vote, meaning that only 3 members need change their mind for the bill to advance in the Senate once more and march on to fairly certain enactment. Joining the two issues also splits both unions and small business; labor favors the wage increase and opposes the Small Business Health Plans concept as drafted, while pairing the provisions is seen as giving business a benefit in the form of theoretically cheaper health insurance to offset the higher wages it will have to pay workers. Experts have disputed whether the Enzi approach would actually lower costs for providing meaningful insurance for most employees.

The combined bill may be brought up after the Summer recess on September 5.

Personal Drug Re-Importation Passes Senate

The Senate adopted by a 68 to 32 vote an amendment to bar the United States Customs and Border Protection Service from preventing an individual from bringing prescription drugs for personal use across the border. People often seek prescription drugs in neighboring countries because prices are often vastly lower than in the U.S.

The vote came during consideration of the funding Homeland Security operations for the coming year. After some consternation among Senators, amendment author David Vitter (R-LA) modified his proposal to apply only to traffic across the Canadian border. Senator Judd Gregg (R-NH) led the opposition to any importation, pitching a new argument that allowing individuals to bring in small quantities of prescription drugs for personal use could be exploited by terrorists to smuggle in dangerous materials. The amendment does not define the allowable amount but restricts those allowed to bring medicine into the country to people with valid prescriptions for FDA approved drugs and thus does not allow any kind of large-scale importation business. The House version of Homeland Security Appropriations contains a similar provision on personal drug importation so enactment of this measure seems likely barring some unforeseen complication. Thus, some small measure of relief from drug costs for individuals may be coming, at least for those who live in the Northern half of the country or otherwise have the means to get to Canada.

California Congressional Delegation

Californian Congressmen Clash Over Instruction of Pension Conferees

Congressman George Miller (D-Richmond) continued to weigh in on the slow-going pension conference with another motion to instruct conferees. On July 20, Miller made the motion to direct conferees to support imposing the same benefit restrictions placed upon CEO's that workers face when benefits are frozen in troubled pension plans. Miller's motion also proposed adopting the tougher Senate plan for transition rules on converting defined benefit into cash balance plans. The motion passed 281-139, with 85 Republicans joining 195 Democrats and 1 Independent in voting for the proposal.

Californian Buck McKeon (R-Santa Clarita) took the opposite side of the debate. Rather than address the underlying issue of fairness, both to older workers usually adversely affected in cash balance conversions or to the CEO benefit issue, McKeon pleaded for an end to distractions so that the pension conference could get along with its work. "The Republicans have led the action in bringing [pension reform] to the floor. We are leading the action in getting the conference report done. We do not want to do anything to hold up that process," McKeon said. McKeon is the Chairman of the House Education and Labor Committee, while Miller is the Ranking Minority Member.

Motions to Instruct are non-binding and simply direct one chamber's negotiators in a conference to begin with a given position. However, such votes do reflect the sentiment of a particular chamber on a given issue.

Matsui Pitches Senate Bill to Divided House

During consideration of the Health Information Technology bill, Congresswoman Doris Matsui (D-Sacramento) took the lead role in a determined but unsuccessful bid to open the rules for considering the House measure so that her colleagues could vote on a substitute. Although called the Democratic substitute, the proposal was based on the bipartisan Senate bill passed unanimously by that chamber in November. Had more Republicans crossed the aisle to join her efforts, the House would have been able to signal its support for the concepts in the Senate's bill and potentially smoothed the upcoming conference between the two versions of health IT.

Related National and Industry News

Support Builds for Ending Generic Drug Settlements

On Thursday, the Senate Special Aging Committee heard testimony from a variety of witnesses, including Federal Trade Commissioner (FTC) Jon Leibowitz and Food and Drug Administration (FDA) Director of the Office of Generic Drugs Gary Buehler, on increasing availability of generic drugs. While this committee has no legislative authority, it can be an important forum to raise and address issues important to seniors that are then taken up more formally in other committees.

Leibowitz's testimony covered the current setting for generic drugs and the FTC's ongoing efforts to bring these cheap, effective treatments to the public with all due speed. Backed by a unanimous vote of the FTC commissioners, Leibowitz spoke for the agency in his remarks.

Rebounding from the Supreme Court's denial of the FTC's appeal on possible anti-competitive collusion between generic and brand name drug makers, Leibowitz and the Commission endorsed the bipartisan S. 3582 by Senators Kohl (D-WS), Leahy (D-VT), Grassley (R-IA), and Schumer (D-NY) as an effective remedy to this growing problem. Senator Kohl is also the top Democrat on the Special Aging Committee.

According to Leibowitz and a host of studies on the topic, delaying the availability of generic drugs costs the public billions each year. He said that seven of ten settlements made this year between generic and brand name makers included a payoff provision for the generic company to delay the entry of its version of the brand name drug. The FTC believes the practice is anti-competitive.

Director Buehler reiterated the importance of generics in his testimony. He generally avoided entering the settlement fray central to Leibowitz's remarks and instead focussed on his office's workload. Buehler attributed the recent tough going at FDA to the increased number of 1990's era patents set to expire soon and noted that his office has kept time for approval of new petitions low. Portions of his testimony suggested that he believed the system for citizen petitions against approval of generic drugs, often used as a stalling tactic by those with an interest in preserving the current patent holder's rights, was not terribly useful as currently constituted.

The testimony of these experts and others provided factual evidence for the record, typically helpful in pursuing legislation, to reform settlement practices among competitors and the petition process. Sadly, very little time remains for the likes of S.3582 to move through the legislative process, despite its impressive backing, and the matter will almost certainly have to wait for next year.

Value of Savings Devices Questioned

A study by the Congressional Research Service (CRS), Congress' independent investigative body attached to the Library of Congress, questioned the effectiveness of the current array of savings devices to make a meaningful or equitable contribution to the overall savings of the nation.

The CRS report characterizes the current savings vehicles such as 401(k) and IRA defined contribution frameworks as having a "mixed" record. This report confirms recurring findings that better-off Americans access tax-preferenced plans at higher rates and derive more utility because they are in higher tax brackets. It shows that previous attempts to increase total individual savings "has been fairly unresponsive to tax incentives," despite their negative effect of those incentives on other kinds of savings such as increasing the Federal deficit. The report does contain a wealth of information about savings, cast in both economic and behavioral model terms, and tracks the motivations of savers at different income levels.

Perhaps most troubling to those with suspicious minds, the CRS repeatedly phrases the value of individual savings inducements like 401(k) plans and IRAs as a percentage of the deficit. The numbers used in the report state that FY 2006's \$125.6 billion in tax expenditures for the policy equals "almost 40% of the estimated FY 2006 deficit." A later mention of the relationship between the two numbers pinpoints the figure at 37.2% of the current year's deficit based on estimates generated by the Congressional Budget Office (CBO), the official scorekeeper of costs, debts, and deficits.

Given the increasing tendency to legislate by anecdote and rely on sloganeering for policy, establishing a link between tax preferences for savings and the deficit can only serve to bind the two more tightly together in the collective Congressional mind. All the large tax expenditures (pension, health, and mortgage deductions) have attracted the attention of deficit hawks in the past and the verbiage found in the CRS report serves to suggest that retirement savings are costs to be cut rather than investments to be made.